



# STATEMENT OF COMPLIANCE WITH **THE MALAYSIAN CODE FOR INSTITUTIONAL INVESTORS** FOR YEAR 2016

## INTRODUCTION

### Background

This policy describes the approach taken by the Employees Provident Fund (EPF) to stewardship and how its policies comply with the requirement set forth by the Malaysian Code for Institutional Investors 2014 (Code). The purpose of the Code is to enhance the communication between institutional investors like EPF and its investee companies that are publicly listed to help improve long term returns to shareholders and further promote good corporate governance among the listed companies.

### What is the Malaysian Code for Institutional Investors?

The Code was launched on 27 June 2014, based on one of the recommendations from the Corporate Governance Blueprint 2011 (CG Blueprint) to formulate an industry-driven code that is expected to strengthen the accountability of institutional investors to their own members and investors. In addition, institutional investors being a major player in the global financial markets have significant influence over their investee companies due to the substantial stake that they hold. This clout can provide the institutional investors with the ability to encourage good governance and influence appropriate behaviours by their investee companies to ensure delivery of sustainable long term value to their shareholders.

The formulation of the Code was done through the Steering Committee and the Working Group comprising senior executives from large institutional investors in Malaysia including EPF, Kumpulan Wang Persaraan (Diperbadankan) (KWAP), Lembaga Tabung Angkatan Tentera (Armed Forces Fund Board), Lembaga Tabung Haji (Pilgrims Fund Board), Pertubuhan Keselamatan Sosial (Social Security Organization), Persatuan Pengurus Aset Malaysia (Malaysia Association of Asset Managers), Persatuan Takaful Malaysia (Malaysia Takaful Association), Pentadbir Pencen Swasta (Private Pension Administrator) and Badan Pengawas Pemegang Saham Minoriti Berhad (Minority Shareholder Watchdog Group).

The Code aims to set out the broad principles of effective stewardship by institutional investors such as their disclosures of stewardship policies, monitoring of and engagement with investee companies, and managing conflict of interests.

## COMPLIANCE WITH THE CODE

### PRINCIPLE 1

#### Disclosing Policies on Their Stewardship

*Institutional investors should disclose the policy on their stewardship responsibilities.*

Since its inception in 1951, EPF invested its funds into a portfolio of diversified asset class comprising government bonds and securities, both private and public equities, money market instruments and real estate. The EPF has a long standing commitment to a solid governance structure as well as disciplined investment procedures and approval processes. The activities and operations of EPF are governed under the EPF Act 1991 whereby investments are made according to Section 26 of the Act.

The Act also provides for the establishment of an Investment Panel who is responsible in making investment decisions. The Investment Panel comprises of representatives from the Ministry of Finance, Bank Negara Malaysia and three others professionals in finance and investment. The Investment Panel formulates investment policies, guidelines and criteria on all investment matters and closely monitors EPF investment activities. The Investment Panel is responsible to ensure prudent management of EPF investment on behalf of its members.

At the management level, before any investment is made, senior members of the investment departments will conduct professional and independent vetting of the investment proposals, and resolve all investment matters through the Management Investment Committee (MIC). The committee, which meets on a weekly basis, is also responsible for the day to day operations of investment activities.

All investment transactions are handled by the Investment Division according to the asset allocation which has been vetted and approved by the MIC, the Investment Panel and Ministry of Finance.

A portion of the fund is outsourced to the external fund managers who have been selected based on a number of criteria which includes the quality of investment philosophy and processes, experience of the organization and the team, consistency of financial performance as well as the organization and board structure.

The EPF Principles of Corporate Governance is set on four main pillars of good stewardship:

- 1 **Effective Board:** Effective and independent Board with highly competent and diverse members to exercise objective judgment
- 2 **Manage Conflicts:** Reduce conflicts of interest between various stakeholders and related parties
- 3 **Efficiency:** Efficient and productive use of resources in the best interests of shareholders
- 4 **Transparency:** Transparency through timely and complete disclosure of important information for effective shareholder decision

**PRINCIPLE 2****Monitoring Investee Companies**

*Institutional investors should monitor their investee companies.*

The EPF's team of investment managers and research analysts rigorously monitor its investee companies. The monitoring process largely comprises meeting management of the investee companies, analysing company annual reports and announcements, investment screening and studying external research. The EPF investment team conduct frequent meetings with the investee companies and ask questions on the company's strategy, financial performance and other relevant issues such as ESG and current developments. Any areas of concern are monitored and raised at dialogue meetings and voting resolutions are analysed before decisions are made. If EPF believes that a decision or proposal by the company's management will negatively affect the company's long-term value, EPF will escalate the issues with written queries, meetings, dialogues or engagement between its investment officers and the company's management. EPF would monitor the company's response to ensure that steps are being taken to address the issues raised in order to protect and enhance shareholders value.

As part of our regular top level engagement program with the investee companies, the EPF CEO led a team of senior investment heads to visit 37 companies under the CEO Visit Program in 2016.

In addition to the CEO Visit Program, EPF Investment team of analysts have completed a total of 493 meetings with over 100 Malaysian companies under coverage in 2016.

**PRINCIPLE 3****Engaging Investee Companies**

*Institutional investors should engage with investee companies as appropriate.*

The EPF believes that alignment of interest between long-term shareholders and companies will fulfill its fiduciary duty to achieve sustainable risk-adjusted returns over the long term. The EPF undertakes engagement with companies on issues that may impact the companies' long term value. Engagement may relate to the company's financial performances, long term strategic plans and ESG issues. Engagement is normally undertaken when it is believed that it would lead to an improvement or prevent deterioration in the company's performance.

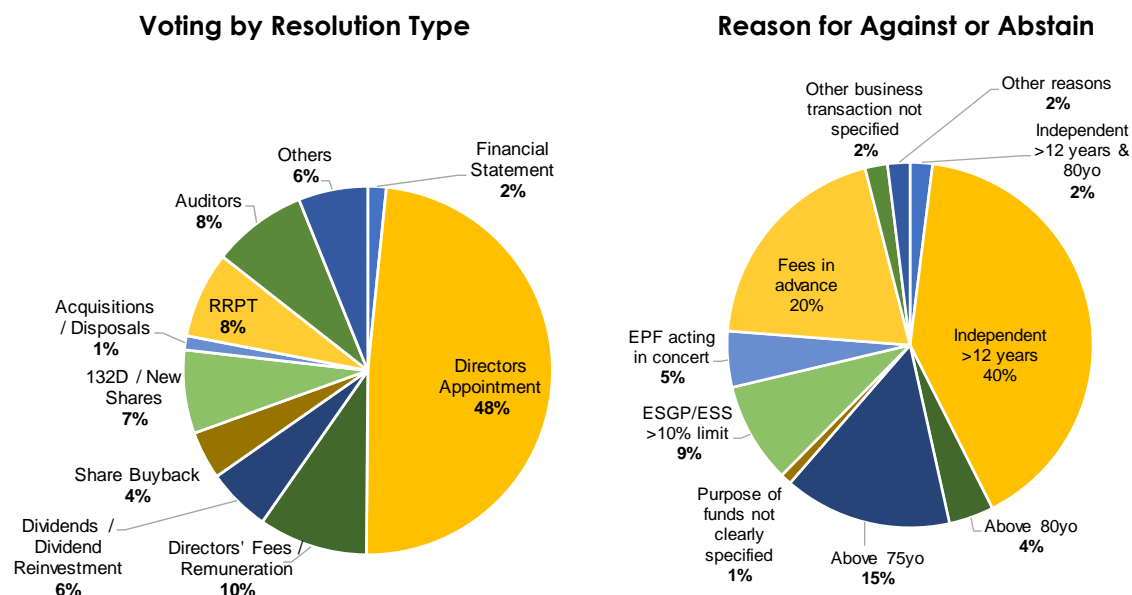
Our approach to engagement activities are based on two prongs:

- The engagement with the board and management of the investee companies on issues of ESG and long term strategy with the objective of maximizing long term shareholders. This is carried out through a scheduled annual engagement by the EPF's top management.
- The engagement with the management of the investee companies by EPF team of analysts on business model and financial performances with the objective of ongoing monitoring of the investee companies.

On a few occasions, further engagement is escalated over time according to the nature and severity of concerns and the responsiveness of the companies to the issues. EPF also engages the companies by attending the shareholders meetings. In addition, alignment of interests can be accomplished through meetings and discussions.

In 2016, EPF attended and voted at 109 shareholders' meetings on 806 resolutions. The Equity Research Department analysed all the resolutions based on the EPF Corporate Governance Principles and Voting Guidelines. The guideline is based on the best governance practices for PLCs and to align to EPF Principles of Corporate Governance.

Charts below show the number of resolutions EPF voted in 2016 and the reasons why EPF decided to vote against or abstain.



In addition to attending regular analysts and shareholders meetings, EPF has also initiated specific engagements with several companies on the following issues:

### Issues on compliance with environmental rules by oil palm plantation companies

Most large oil palm companies are members of the Roundtable of Sustainable Palm Oil (RSPO) but one company has its RSPO certification suspended due to complaints by Aid Environment regarding its Indonesian operation. EPF has written to the company highlighting our concern on the issue and has requested for the company to explain the real issues concerning the suspension of the RSPO certificate, the steps to be taken to mitigate the impact of prolonged suspension in the future and the implication on the Group's income and profitability.

Another company has voluntarily withdrawn its RSPO certification to safeguard its smallholders' and settlers as it made up 30% of the group's production. EPF has also written to the company on the issue and has asked them to explain the potential impact from this withdrawal to the company's earnings, the effort taken by the company to overcome the negative sentiments in the market following the withdrawal and the time it will take to rectify the problem and re-apply for RSPO certification.

In both cases, EPF's concerns go beyond the financial and reputational impact on these companies.

### **Issues on Environmental, Labour, Safety and Health Standards**

Poor infrastructure from mining to transportation of the recently discovered bauxite mineral in the east coast of Malaysia has led to the local community being exposed to serious environmental and health issues. EPF has highlighted its concern to a related company and the company has responded with a comprehensive list of on-going actions taken to ensure that the handling of bauxite in the area will not cause further harm to the local environment.

In two other cases involving listed property companies, the collapse of a pedestrian bridge under construction near Mid Valley Megamall and the freak accident where a crane hook fell and killed a motorist in KL city centre are examples of breaches in the health, security and safety standards. EPF has written to the companies involved for proper disclosure on their involvement and steps taken to mitigate risks on occupational safety and health issues arising from their activities.

There was an article reported by a foreign media claiming that a listed company, involved in the refurbishment of a stadium in the Middle East, has violated the human rights of its foreign labours. Although the company went through numerous rectification process, it has been banned from subsequent related projects until it shows "sustainable improvements" in its conduct. As a shareholder, EPF is committed to ensure fair labour practices by its investee companies and has highlighted our concerns on the matter, demanding for justifications from the company on the potential impact to its operations, financials, as well as measures to overcome the problem.

### **Issues on directors' remuneration**

2016 was a challenging year for the oil and gas industry following the sharp fall in oil price. However, when an executive director of an oil and gas company received an extremely huge pay in cash and share grant despite the company reporting a loss in the recent financial year, EPF immediately engaged with the company and its Chairman to demand an explanation. While the issue is still yet to be resolved, EPF has put the company under close watch to ensure executive pay commensurate with the performance of the company.

### **Issues on conflict of interest**

Pursuant to a company's resolution in a shareholder meeting for the renewal of the existing mandate for recurrent related party transactions, EPF has engaged with the management to remove the IT transition and related costs payable amounting to RM42.4 million and expense it to the other party instead. EPF views that these costs should be incurred by the major shareholder instead of the company to ensure fairness to the minority shareholders.

**PRINCIPLE 4****Managing Conflicts Of Interest**

*Institutional investors should have a robust policy on managing conflicts of interest which should be publicly disclosed.*

The EPF is committed to adhere to the highest standard of corporate governance throughout the organization as a fundamental part of discharging its fiduciary duty to protect and enhance members' savings. EPF has put in place various policies to address potential conflicts of interest in relation to stewardship. This serves to maintain the integrity of decision-makers in EPF when dealing with and managing its investments.

In respect of conflicts of interest within the fund, members of the EPF Board, Investment Panel and sub-committees are required to make declarations of interest prior to meetings and abstain from taking part in the discussion and decision making. For example, if it concerns a related-party transaction in which a member of EPF Investment Panel is also sitting in the public-listed Board, the person will be excused from attending such discussions.

In addition, the following policies were also implemented to address possible conflict of interest within EPF:-

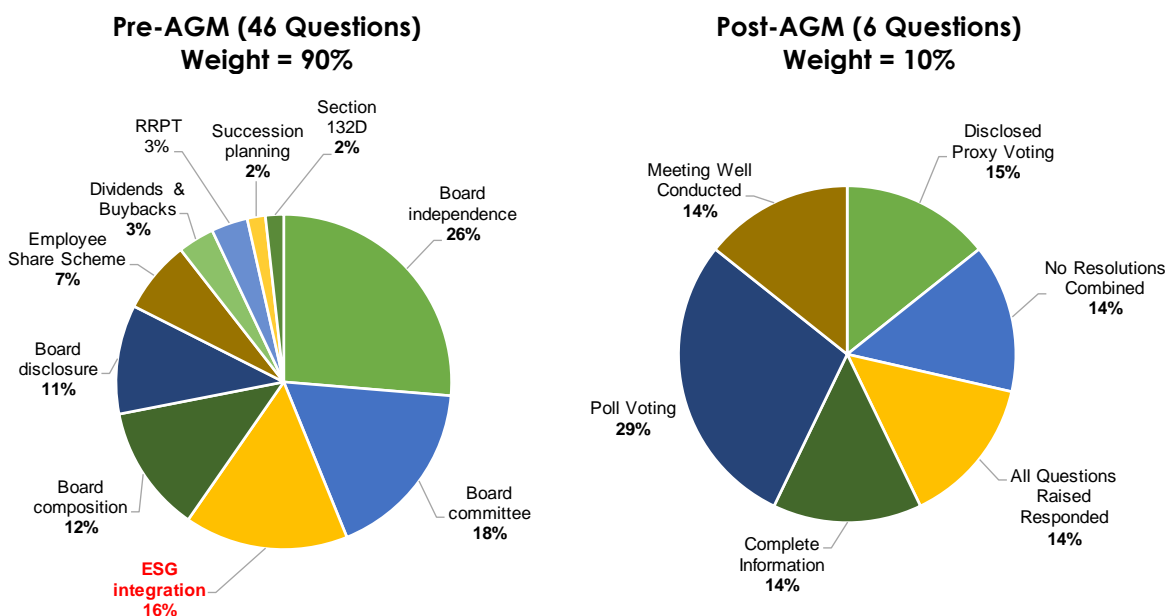
- Restrictions on Listed Equity Transactions on investment officers
- Chinese Wall Policy
- No Gift Policy
- Declaration of Interest/Relationship with Panel Brokers for Equities
- EPF Code of Ethics
- Staff Declaration of Asset Ownership

**PRINCIPLE 5****Incorporating Sustainability Consideration**

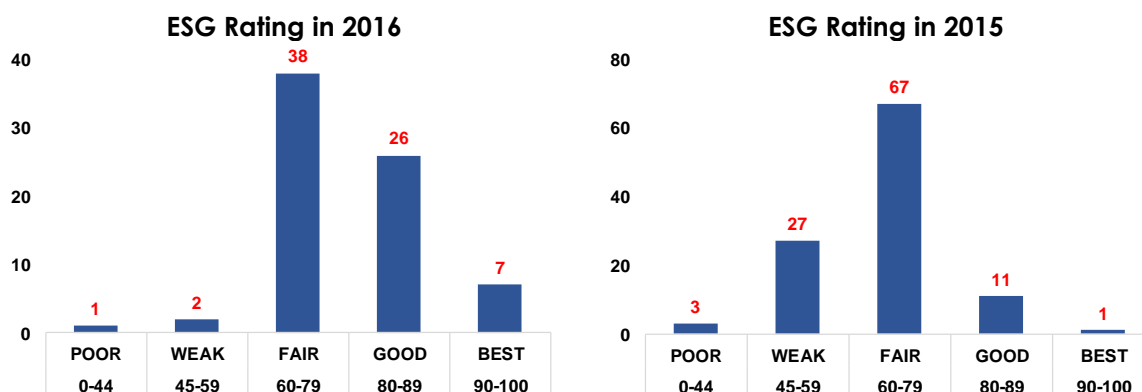
*Institutional investors should incorporate corporate governance and sustainability considerations into the investment decision-making process.*

Sustainability in investment is defined as the ability to continue doing business in a responsible manner, taking into account the impact on environment and social context while ensuring long term performance and existence. Traditionally EPF has been active in monitoring the governance aspect of our investee companies ever since the first establishment of the Malaysian Code of Corporate Governance in 2012. Over time, these considerations have evolved to include the environment and social aspects of corporate behaviours. EPF continues to believe that strong governance practices, along with deeper concerns for the environment and social risks are important drivers of investment value. In addition to the financial and governance aspect of a company that EPF has focussed on in the past, we have begun to integrate ESG aspects into our investment monitoring process that relates to how a company achieve its long-term financial goals and at the same time generate positive impact on the environment and social. The preliminary analysis is also done at the screening stage, mainly to filter out certain investments from an ethical perspective (tobacco, gambling, liquor, etc.). With the commencement of Shariah-based option, the process of integrating ESG factors into our investment processes and decisions will be more intensified. EPF has also developed its own internal rating tool to monitor and evaluate company performance in the aspect of ESG. With improved disclosure standards on ESG by the investee companies under Sustainable Reporting and/or Integrated Reporting initiatives by Bursa Malaysia, we are set for a long term journey to elevate the level of awareness on ESG standards in Malaysia.

EPF has developed its own internal rating tool to assess the quality of ESG aspects by its investee companies under surveillance which is based on questions from how the company adhere to the CG code, disclosure standards and how the company integrate ESG, all the way to the conduct of general meetings. This tool is able to generate a quantifiable rating which can be considered when evaluating the companies in addition to the traditional quantitative analysis done on their financials.



Based on the 74 companies evaluated in 2016, we found out that ESG distribution is left-skewed, suggesting that more companies have moved on to higher ranks. Bursa Malaysia maintains its position as the best ESG company within our coverage, followed by CIMB, Maybank, Axiata, and DRB-Hicom. The bottom five were led by YTL Corp, YTL Power, Yinson, Oriental Holdings and United Plantations. Going forward, we will continue to enhance our rating mechanism by increasing the weight on ESG integration, in line with the sustainability agenda.



**PRINCIPLE 6****Publishing Voting Policy***Institutional investors should publish a voting policy.*

EPF values the voting rights attached to its equity holdings in Malaysian listed companies and will always exercise those rights to ensure that its economic interest is protected. EPF Corporate Governance Principles and Voting Guidelines is published in our website.

<http://www.kwsp.gov.my/portal/en/web/kwsp/about-epf/investment-highlights/corporate-governance/epf-corporate-governance-principles-and-voting-guidelines-booklet>

Essentially, EPF will generally vote in favour of resolutions which are in line with the Malaysia Corporate Governance Code and are in the best interest of all shareholders. EPF may also decide to vote against or abstain on resolutions which do not meet these guidelines and are deemed to have conflicts of interest, poor transparency or what EPF believes to be detrimental to the long term value to shareholders.

Similarly, we have directed our external asset managers to vote in accordance with the latest ruling in EPF Corporate Governance Principles and Voting Guidelines.

Disclosure of our voting activity is provided in sections above and will also be published on EPF website. This includes both the total number of company meetings where the EPF has voted and details of issues where we have voted against company management.

**END**